

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: AR&T Committee Analyst: LuAnna Hass Bill Number: AB 3071
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: March 8, 2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Innocent Spouse Technical Clean-Up

SUMMARY

This bill would remove an erroneous statutory reference relating to relief from joint and several liability.

PURPOSE OF THE BILL

The purpose of this Franchise Tax Board (FTB) sponsored bill is to correct an erroneous reference within the California Revenue and Taxation Code to ensure the provisions of law are consistent and to prevent confusion for taxpayers and the department when applying state law.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2005, and operative on and after that date.

POSITION

At its December 3, 2003, meeting the Franchise Tax Board voted 2-0 to support this bill with the representative of the Department of Finance abstaining.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state income tax law, spouses who file a joint tax return are individually responsible for the accuracy of the return and for the full tax liability for that tax year. These obligations apply regardless of which spouse earns the income. The concept of obligating each spouse individually for all of the tax liability is called joint and several liability. Joint and several liability can result in inequitable consequences to one spouse in certain circumstances. Consequently, the federal government and California enacted "innocent spouse" legislation, which may allow a spouse to be relieved of some or all of the responsibility of a joint tax debt.

The federal Internal Revenue Restructuring and Reform Act of 1998 (the "1998 Act") made innocent spouse relief easier to obtain. The 1998 Act allows an innocent spouse to qualify for relief under one of the following three provisions. In order for a taxpayer to qualify for relief under either 1 or 2 below, the taxpayer must elect relief within two years of the date the Secretary has begun collection activities with respect to the taxpayer making the election.

Board Position:	Department Director	Date
_____ S _____ NA _____ NP		
_____ SA _____ O _____ NAR	Gerald H. Goldberg	4/15/04
_____ N _____ OUA _____ <u>X</u> PENDING		

1. *Understatement/Apportionment.* A spouse may elect to be relieved of a tax liability for a taxable year to the extent the liability is attributed to an assessment of tax exceeding the amount reported on the return (also called “understatement of tax”). Generally, the requesting spouse must show that the understatement of tax is a result of an erroneous item, such as an omission of income or an overstatement of deductible expenses, which results in an understatement of tax. In addition, the taxpayer must show that at the time the return was signed he or she did not know and had no reason to know of the erroneous item, as described above, that led to the understatement of tax.

A taxpayer who would qualify for relief but for the knowledge requirement of the full amount of the understatement of tax, as described above, may be allowed relief for a portion of the understatement. If the taxpayer can show lack of knowledge, as described above, with respect to *a portion of the understatement*, then the taxpayer may be relieved of liability for the tax that is attributable to that portion of the understatement.

2. *Separate liability election.* A requesting spouse may elect to be taxed as though he or she filed a *married filing separate* tax return. Any liability for any deficiency that is assessed on the joint return, (including applicable interest, and penalties) will be limited to the amount properly attributable to the requesting spouse as if a separate return had been filed. This relief is available to taxpayers who are no longer married, are legally separated, or have lived apart from their spouse for 12 months prior to requesting relief. At the time the joint return was signed, the requesting spouse must have lacked actual knowledge of the item resulting in the tax deficiency.
3. *Equitable relief.* If the Internal Revenue Service (IRS) determines from a review of all the facts and circumstances that the requesting taxpayer would not qualify for relief under either 1 or 2, above, the IRS may determine that it would not be equitable to hold the requesting spouse liable for any unpaid tax or any deficiency.

In 1999 California conformed to portions of the 1998 Act by enacting the Taxpayers’ Bill of Rights Act of 1999, which revised and expanded state innocent spouse relief to be similar to the federal provisions outlined above. Like federal law, the taxpayer must make the election within two years of the date that FTB begins collection activities.

THIS BILL

This bill would remove an erroneous reference to a non-existent *four-year* period for making an election. This would clarify existing law that taxpayers must request innocent spouse relief within *two years* from the date FTB begins collection activities.

IMPLEMENTATION CONSIDERATIONS

Since this bill would only clarify existing law, this bill would not impact the department’s programs or operations.

LEGISLATIVE HISTORY

SB 285 (Speier, Ch. 370, Stats. 2003) provides that if an individual receives relief from income tax liabilities under the federal innocent spouse provisions, that individual also receives relief under the state innocent spouse provisions.

AB 2979 (Assembly Revenue and Taxation Committee, Ch. 374, Stats. 2002) increased the gross income and tax liability thresholds to qualify for relief under a divorce court order to reflect inflation from 1977 to 2001, so that the amounts became \$150,000 for the gross income threshold and \$7,500 for the state income tax liability threshold.

OTHER STATES' INFORMATION

Information on other states is not relevant as this bill makes a minor technical change for code maintenance purposes to California statutes.

FISCAL AND ECONOMIC IMPACT

This bill would not impact the state's income tax revenue or the department's current programs or practices.

ARGUMENTS/POLICY CONCERNS

Erroneous references should be corrected to ensure the provisions of law are consistent and to prevent confusion for taxpayers and the department when applying state law.

LEGISLATIVE STAFF CONTACT

LuAnna Hass
Franchise Tax Board
845-7478
luanna.hass@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov